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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 1037

I. HASBROUCK CHAHOON,

Petitioner,

v.

HARRY M. HICKEY, Collector of United States Internal Revenue for the Fourteenth District of New York,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

LAURENCE GRAVES,
Counsel for Petitioner,
20 Exchange Place,
New York 5, N. Y.

Pandick Press, Inc., 22 Thames St., New York 6, N. Y., U. S. A.

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HARRY M. HICKEY, Collector of United States Internal Revenue for the Fourteenth District of New York,

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PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR SECOND CIRCUIT.

To the Honorable the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The above named Petitioner prays that a writ of certiorari be issued to the United States Circuit Court of Appeals for the Second Circuit to review a judgment of that court rendered in the above cause on January 2, 1946 (R. 11) reversing a decision of the United States District Court for the Northern District of New York which held that the petitioner was entitled to recover an overpayment of income tax made for the calendar year 1936, in the amount of $11,311.45, together with interest thereon (R. 1).

The District Court had approved the deduction under section 23(a) of the Revenue Act of 1936, as a business expense or under section 23(e) of that Act, as a business loss, a payment of $48,000 made under an agreement with the Plattsburgh National Bank and Trust Company, and the question is whether the Circuit Court of Appeals was in error in reversing this decision.

Jurisdiction.

The jurisdiction of this court is invoked under section 240(a) of the Judicial Code as amended.

The Opinions of the Courts Below.

The opinion of the District Court (R. 1) is reported in 60 F. Supp. 406. The opinion of the Circuit Court of Appeals (R. 8-10) has not been officially reported.

Statute Involved.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> "SEC. 23, DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition

of the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * * *

(e) Losses by Individuals.—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * * * *

Summary Statement of Matter Involved.

Petitioner maintains that he was engaged in business and entitled to deduct from gross income under section 23(a)(2) or under 23(e) of the Revenue Act of 1936 a payment of $48,000 made to the Plattsburgh National Bank and Trust Company as an ordinary and necessary business expense or as a loss incurred in his business. The District Court held on the facts of this case that the payment was an allowable deduction "either as a necessary business expense or a business loss". The Circuit Court of Appeals reversed the District Court on the ground that it thought "that the trial judge made an unjustifiable inference when he said that taxpayer's participation in the transaction in question was a normal business transaction made to protect his extensive interests and substantial salaries in the various corporations, particularly the Bank".

Facts.

The petitioner had extensive business interest in the Adirondack area of New York State consisting of Franklin, Clinton and Essex counties. He was a substantial stockholder, as well as a director and salaried officer, of a number of corporations having assets worth several millions of dollars. He was president of the largest bank in such area. He devoted his entire time to the management of the affairs of these corporations.

During the banking crisis of 1931, petitioner, together with certain other individuals, entered into an agreement with the Plattsburgh National Bank and Trust Company, of Plattsburgh, N. Y., of which he was president, the purpose of which was to bolster the assets of the bank in order to prevent its threatened closing by the Comptroller of the Currency. This agreement was terminated in 1936 and petitioner paid the bank $48,000 to satisfy his obligation under the agreement. This $48,000 was claimed as a deduction by petitioner in his 1936 Federal income tax return. The claimed deduction was disallowed by the Commissioner of Internal Revenue and an additional tax of $11,311.45 was assessed and paid. A claim for the refund of said payment was duly filed. The claim for refund was disallowed and suit was brought in the United States District Court for the Northern District of New York.

The District Court, on the basis of a lengthy stipulation of facts and the oral testimony of the petitioner, made findings of fact and conclusions of law. It found as facts, among other things, that at all times material petitioner was actively engaged in business, that his participation in the agreement with the Trust Company was a normal business transaction, and that the payment of $48,000 was both an

ordinary and necessary business expense incurred by plaintiff in carrying on his business and a loss incurred in his trades of businesses. The court then concluded as a matter of law that petitioner was entitled to the deduction of $48,000, either as a necessary business expense or a business loss, under section 23(a) of the Revenue Act of 1936.

The Circuit Court of Appeals reversed this decision (R. 8). All that was before the Circuit Court of Appeals, as the record on appeal, was the Findings of Fact and Conclusions of Law together with the Judgment of the District Court (R. 1-7). The appellant below did not bring up the stipulation of facts or the testimony of petitioner in the District Court upon which such Findings of Fact were based. Nevertheless, the Circuit Court concludes, without reviewing the evidence considered by the District Judge, that the findings of fact made by him were not justified.

The heart of the difference between the District Court and the Appellate Court was that the former found that the petitioner was actively engaged in business, that his participation in the agreement with the Trust Company was a normal business transaction, and that the payment of $48,000 under said agreement was both an ordinary and necessary business expense in carrying on his business and a loss incurred in his trades or businesses, whereas the Circuit Court ignored the facts found by the District Court, as well as the contentions made by the petitioner, assumed an argument for the petitioner and concluded by holding that the trial judge made an unjustifiable inference when he found as a fact that the petitioner's participation in the transaction "was a normal business transaction made to protect his extensive interests and substantial salaries in the various corporations, particularly the Trust Company."

Questions Presented.

1. Did the Circuit Court of Appeals err in reversing the decision of the District Court, in holding that the findings of fact made by the District Court were not justified, without having before it the evidence that was considered and weighed by the District Court?

2. Did the Circuit Court of Appeals err in reversing the decision of the District Court that the payment was an ordinary and necessary expense or a loss of petitioner's trade or business?

Reasons Relied Upon for Granting of Writ.

This case was tried before the District Judge, without a jury, upon a stipulation of facts consisting of 8 pages with 59 pages of exhibits, together with the oral testimony of petitioner, which covers 15 pages of transcript. From this evidence the District Judge made his findings of fact and conclusions of law, and judgment was entered for petitioner.

Assuming that the findings of fact made by the District Judge did involve mixed questions of law and fact, the question for decision by the Circuit Court of Appeals was whether or not such findings were supported by the evidence. *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481. The summary action of the Circuit Court in reversing the District Court without an examination of the evidentiary facts was without legal justification.

The conclusion of the Circuit Court of Appeals is in conflict with numerous decisions of the United States Board of Tax Appeals involving substantially identical questions. See *Bank of Skowhegan*, 35 B. T. A. 876; *Robert Gaylord*,

Inc., 41 B. T. A. 1119, and *Maloney Electric Company*, 42 B. T. A. 78. Its decision also conflicts with the conclusions reached by the Supreme Court of the State of New York, Appellate Division, Third Department in *People ex. rel. I. Hasbrouck Chahoon* v. *Mealey et al. constituting the State Tax Commission* (1944), 268 App. Div. 49, which involved the identical question under the New York State tax law.

WHEREFORE, petitioner respectfully prays that a writ of certiorari be issued under the Seal of this Court to renew the decision of the Circuit Court of Appeals for the Second Circuit in the above case, and that said decision be reversed.

I. HASBROUCK CHAHOON,
Petitioner.

By LAURENCE GRAVES,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION.

Questions Presented, Statement of Case, Statutes Involved.

The statement of questions presented, the statement of the case, and the statutes involved will be found in petition.

Specification of Errors and Summary of Argument.

1. The Circuit Court of Appeals erred in reversing the decision of the District Court that petitioner was actively engaged in business; that the transaction in question was a normal business transaction and that the payment was an ordinary and necessary business expense of his business under section 23(a) and a loss incurred in his trades or businesses under section 23(e). Such questions were questions of fact or at most mixed questions of fact and law. The Circuit Court of Appeals was without authority to reverse the District Court on these questions, without ascertaining whether or not the evidence supported the findings made by the District Court. This the Circuit Court could not and did not do.

2. The Circuit Court of Appeals erred in disregarding the law established on the questions involved by the uniform decisions of the United States Board of Tax Appeals as well as the decision on the identical question under a like statute by the Appellate Division of the Supreme Court of the State of New York.

ARGUMENT.

I.

The Circuit Court erred in reversing the District Court on the fact questions involved, without reviewing the evidence.

The record before the Circuit Court in this case was the Findings of Fact and Conclusions of Law made by the District Judge after consideration of all of the evidence presented at the trial, which was considerable. Without as much as the availability of such evidence for review, the Circuit Court reversed by stating that the District Court was not justified in making the findings that it did. Such procedure, it is submitted, is erroneous and without legal authority.

In cases originating in The Tax Court of the United States, the rule as established in *Commissioner* v. *Heininger*, 320 U. S. 476, *Dobson* v. *Commissioner*, 320 U. S. 480 and as expressed in *Commissioner* v. *Scottish American Co.*, 323 U. S. 119, 123-124 is:

> "The Tax Court has the primary function of finding the facts in tax disputes, weighing the evidence, and choosing from among conflicting factual inferences and conclusions those which it considers most reasonable. The Circuit Courts of Appeal have no power to change or add to those findings of fact or to reweigh the evidence * * *. If a substantial basis is lacking the appellate court may then indulge in making its own inferences and conclusions or it may remand the case to the Tax Court for further appropriate proceedings. But if such basis is present the process of judicial review is at an end."

In the case at bar there was nothing before the Circuit Court from which it could have drawn inferences of fact,

nor could it say, on the record that was before it, that the case should have been remanded for lack of substantial evidence to sustain the findings, inferences and conclusions of the District Court.

The reasoning of the *Heininger* and the *Dobson* cases is not based so much upon the particular skill and specialized experience of the judges sitting in the Tax Courts, as it is based upon the policy against cluttering the appellate courts with what are essentially questions of fact. We respectfully submit that the determination of a Federal District Judge after a full trial before him, is entitled to the same presumptions of regularity and conclusiveness as those of a Judge of the Tax Court.

We should be the last to suggest that the judgment of a United States District Judge on the facts in a tax case is necessarily inferior to that of a Judge sitting in the Tax Court. If such should turn out to be the law, we venture to suggest that a proper caution would lead taxpayers to seek always the traditional jurisdiction of the District Courts, where either party might, under the law as understood before the decisions of the *Heininger* and *Dobson* cases, have possibly two and even three bites at the cherry, when the facts were in dispute before the District Court and brought under review in the Circuit Court of Appeals and finally to this Court.

The rule is no different where the question is a mixed question of fact and law. The test still remains, "is the decision of the lower court supported by the evidence". *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 871. This can be determined only from an examination of the evidence. The Circuit Court was in no position to do this in the instant case.

II.

The decision of the Circuit Court is in conflict with established line of decisions.

The question before the District Court had been decided by the Board of Tax Appeals in three cases, *Bank of Skowhegan*, 35 B. T. A. 876; *Robert Gaylord, Inc.*, 41 B. T. A. 1119, and *Maloney Electric Company*, 42 B. T. A. 78. The petitioner successfully litigated the question in the New York Courts in *People ex rel. I. Hasbrouck Chahoon* v. *Mealey et al. constituting the State Tax Commission*, 268 App. Div. 49. The decision of the Circuit Court in the case at bar is in conflict with all of these decisions.

Conclusion.

For the foregoing reasons it is respectfully submitted that the petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit should be granted.

Respectfully submitted,

LAURENCE GRAVES,
Counsel for Petitioner,
20 Exchange Place,
New York 5, N. Y.

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In the Supreme Court of the United States

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I. HASBROUCK CHAHOON, PETITIONER

v.

HARRY M. HICKEY, COLLECTOR OF UNITED STATES INTERNAL REVENUE FOR THE FOURTEENTH DISTRICT OF NEW YORK

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 2–7) are reported in 60 F. Supp. 409. The opinion of the Circuit Court of Appeals (R. 8–10) has not yet been reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on January 2, 1946. (R. 10.) The petition for a writ of certiorari was filed on April 1, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner was president and a stockholder of a bank; he was also a stockholder in several corporations that had deposits in that bank. The bank was solvent. In computing his net income may he deduct, as a business expense or as a loss, an amount paid under an agreement to idemnify the bank against loss from depreciation in the value of its securities?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.
>
> * * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

STATEMENT

The facts were stipulated by the parties and found by the District Court (R. 2–7) as follows:

The taxpayer, in 1931, was the president of Plattsburg National Bank & Trust Company, Plattsburg, New York, and was the owner of 148 of the 5,000 issued shares of the bank's capital stock. (R. 3, 5.) His salary was $10,000 per annum until January 1, 1934, when it was reduced to $5,500. (R. 3.) He also received substantial salaries from several corporations in which he and his family were stockholders, and those corporations had some $256,000 on deposit with the bank. (R. 3–4, 6.)

In July, 1931, the bond portfolio of the bank showed a shrinkage in value of $440,000. Although that shrinkage and other losses resulted in an impairment of capital, the bank was solvent and had a net capital of some $353,000 after deducting all estimated losses. (R. 5, 9.) The bank examiners recommended that something be done to improve the bank's position and, to meet

this suggestion, the taxpayer and other stockholders and directors of the bank entered into an agreement whereby they gave their personal notes aggregating $400,000 to underwrite any loss to the bank arising out of the shrinkage in value of bonds held by the bank. The amount of the notes was the amount of the difference between the cost of the bonds and their then market value. (R. 6.)

Under the agreement, the taxpayer and the other subscribers were bound to make up the difference between the ultimate selling price and the cost of the bonds to the extent of $400,000. The agreement provided that if the sale of the bonds resulted in a profit, the profit was the bank's. The taxpayer gave his note for $100,000. (R. 6.)

In 1936, the taxpayer and the other subscribers were required to make good the difference between the cost and the market value of the bonds. The taxpayer's share of the difference was determined to be $48,000 which he paid in cash in that year. (R. 6.)

In his income tax return for that year, the taxpayer took this amount as a deduction. (R. 6.) The Commissioner disallowed the deduction and, as a result, assessed a deficiency in income taxes in the sum of $11,311.45 which was paid on February 8, 1939. (R. 2–3.)

On February 6, 1941, the taxpayer filed a claim for the refund of the amount thus paid which the Commissioner rejected by registered letter dated March 2, 1942. This suit was commenced on February 29, 1944. (R. 3.)

Upon these findings, the District Court concluded that the taxpayer was entitled to the deduction claimed, either as a necessary business expense or as a business loss, and granted judgment as demanded in the complaint. (R. 7.)

The Circuit Court of Appeals held that the deduction was not allowable either as a loss or a business expense and reversed the judgment of the District Court. (R. 8–10.)

ARGUMENT

Taxpayer erroneously asserts that the Circuit Court of Appeals reversed the findings of the District Court and drew different inferences of its own without an opportunity to examine the evidence. On the contrary the decision of the Circuit Court of Appeals was based upon the view that the findings of the District Court did not support its judgment.

The findings disclosed that the taxpayer agreed to indemnify a bank against losses on the sale of certain bonds which had depreciated in value; that he made himself liable to the extent of $100,000; that various corporations in which he was interested and from which he drew salaries

had large deposits in the bank (R. 6); that the bank had sufficient assets to pay its depositors in full (R. 5); and that in 1931 the taxpayer received a salary of $10,000 from the bank, which was reduced in 1934 to $5,500 (R. 3). The District Court further found that the taxpayer's participation in the agreement was a normal business transaction made in order to protect his extensive interests and substantial salaries in the various corporations, particularly the bank. (R. 7.)

It is settled that expenses incurred by an individual to protect the business of a corporation in which he is interested are not ordinary and necessary expenses of the individual. *Burnet* v. *Clark,* 287 U. S. 410; *Deputy* v. *du Pont,* 308 U. S. 488. Similarly it has been held that such expenses are not deductible as losses. *In re Park's Estate,* 58 F. 2d 965 (C. C. A. 2d), certiorari denied, 287 U. S. 645. The District Court found that the expenses here involved could be disassociated from the bank by reason of the taxpayer's interests in depositors of the bank who might suffer from the latter's failure. But the Circuit Court of Appeals properly pointed out that the bank had sufficient assets to pay its depositors in full and that hence the potential liability of $100,000 assumed by the taxpayer had no reasonable business relationship to the losses he would have suffered if the bank had been closed.

Thus the Circuit Court of Appeals reversed the decision of the District Court for its failure to apply the rule of law announced in the cases cited above. Moreover, it would have been appropriate for the court to go further and hold that the rule of the above cited cases could not be avoided even if the taxpayer's assumption of liability had been necessary to protect the depositors.

Since we think that a Tax Court decision would have been reviewable under similar circumstances, there is no occasion here to consider whether the rule of *Dobson* v. *Commissioner,* 320 U. S. 489, has any application in an appeal from a District Court.

CONCLUSION

The decision of the court below is correct and there is no conflict of decisions. The petition should be denied.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.

SEWALL KEY,
Acting Assistant Attorney General.

J. LOUIS MONARCH,
FREDERIC G. RITA,
Special Assistants to the Attorney General.

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